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THE MASSACHUSETTS STATE LOTTERY

SPECIAL REPORT

1989 Lottery Efficiency Study: Part I, United States

Md., Mass. top revenue, sales producers

By Terri La Fleur

Our fifth annual study of the efficiency of the U.S. lottery industry ranks the 27 lotteries operating in fiscal 1988. All data reflects audited figures from annual reports.

Each lottery's performance is measured against the percentage of the state's calendar 1988 personal income captured as sales and brought down to the bottom line as net government revenues.

Table 1 ranks the 27 lotteries according to their efficiency in generating gov-

Table 2

Lotteries ranked by fiscal 1988 sales as a % of state personal income

Lottery	1988	1987
1. Massachusetts	1.129%	1.137%
2. D.C.	.915%	.964%
3. Maryland	.905%	.946%
4. Ohio	.817%	.882%

Table 1

Lotteries ranked by fiscal 1988 government revenues as a % of state personal income

Lottery	1988	1987
1. Maryland	0.393%	0.414%
2. D.C.	0.363%	0.360%
3. Massachusetts	0.340%	0.371%
4. Michigan	0.320%	0.289%

GOVERNMENT DOCUMENTS COLLECTION

MAY 4 1990

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--Bookies say they are put out of business

--National study calls Massachusetts "acknowledged industry leader"

--Local aid rises from $48 million in FY79 to $453 million in FY89

--High prize levels are the basis for success--Gaming and Wagering Magazine

The following pages contain information which documents the fact that the Massachusetts State Lottery is the number one lottery in the country in per capita sales. More importantly, this data indicates how and why Massachusetts became number one and points out some of the risks associated with tampering with a winning formula.

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LOTTERY PAYS OFF FOR PLAYERS AND COMMUNITIES

Recently, Boston area bookie Harry "Doc" Sagansky said the Lottery practically put him out of business, according to the Boston Herald of November 15, 1989, page 4.

FBI tapes printed by the Boston Globe in its story of organized crime Nov. 19, 1989, on page 46, noted Sagansky said, "What I'm driving at is that the business has been destroyed. You pick up the paper, and look at the payoffs on the four numbers and the three numbers and the four numbers is almost 100 percent more if you play with the lottery...."

How did the Lottery do that? By studying the bookie's methods and improving the game for the bettors. That meant plugging a guaranteed 60% in the prize pool. The game has increased in revenue from $1 million a week in the late 1970's to $9 million a week in 1989.

Action taken by the House during the budget debate threatens to dismantle the efforts of the lottery to build for the future and jeopardizes $100 million in local aid. Specifically, two budget cuts, the first, level funding the agency and the second, cutting an additional $3.25 million reduces the lottery's ability to reach its customers as advertising and product support must be reduced. Despite wide-spread misconceptions, the lottery's advertising budget has been modest when measured by accomplishments.

For the past five years, advertising expenditures have averaged about $11 million annually or .8 % of gross. The national advertising expenditure of 29 lottery states is closer to 2 % of gross. (*An accompanying chart provides details*).

Yet, with year-to-date per capita sales of $5.17 per week, Massachusetts is the leader among United States lotteries. The following tables provide information as of Nov. 16, 1989 from 29 reporting lotteries.

WEEKLY PER CAPITA SALES
U.S. LOTTERIES

1.	Massachusetts	$5.17
2.	Indiana	4.98*
3.	District of Columbia	4.37
4.	Maryland	3.28
5.	Florida	3.22
6.	New Jersey	3.19
7.	Connecticut	2.99
8.	Pennsylvania	2.73
9.	Illinois	2.66
10	Ohio	2.62
11.	Michigan	2.32
12	New York	2.20
13.	Delaware	1.99
14.	California	1.86
15.	Kentucky	1.82
16.	New Hampshire	1.60
17.	Maine	1.55
18.	Virginia	1.43
19.	Arizona	1.42
20.	Vermont	1.37
21.	Iowa	1.17
22.	Oregon	1.16
23.	Washington	1.14
24.	Wisconsin	.91
25.	Missouri	.83
26.	Kansas	.63
27.	West Virginia	.63
28.	Colorado	.57
29.	South Dakota	.55

*Indiana began on 9/20/89

A second major impact on the lottery occurs under a provision which would limit prize levels in the Instant and Numbers Game. These games provide the lion's share of local aid. The ability to attract customers with attractive games and prizes has brought the lottery to its lofty position as attested to by national magazine and accounting studies.

In the late 1970's the Instant Games sold at the rate of less than $1 million a week, with prizes based on 45 % of gross income. Ten years later, with prizes averaging 65%, sales are constant at $12 million per week. (*See accompanying chart*).

Industry writers look at Massachusetts and conclude we are doing something other states should emulate. Gaming and Wagering Business Magazine in its Oct. 15, 1989 edition said,

"For the fourth year in a row, the Massachusetts lottery ranked as the most efficient U.S. Lottery as a sales producer....The Bay State lottery also is the most generous in prize payouts, returning 59.3 % of total ticket sales as prizes in fiscal 1988."

"While critics suggest that higher prize payouts reduce the amount of money returned as net government revenues, it should be noted that the Massachusetts lottery ranked number three according to government revenues as a percentage of personal income and per-capita government revenues. *Apparently players who win more also put more money back in play, thereby delivering more dollars to the bottom line despite the higher payouts."* (Italics supplied.)

Forbes Magazine in its March 6, 1989 issue examined the national lottery scene and stated, in part, "Massachusetts' is generally recognized as one of the best run lotteries in the country, and it boasts the highest per capita sales in the business. One reason is that Massachusetts has been paying out more and more of the lottery's sales in prizes, as much as 60 %, versus 45 % only five years ago....."

What is the result? More money for the players and for the cities and towns. From $48 million for local aid in FY1979 to $453 million in FY1989.

The Massachusetts State Lottery is the most successful in the country because buyers, players, call them what you will, get their money's worth with the highest level of prize money paid to winners of any lottery in the country--59%.

The players like it that way and they vote with their dollars. Over the18-year history of the Lottery we have experimented with a number of games and prize payouts. The only constant proven during this time is that players, and they amount to more than 60 percent of the adult population, will buy more tickets in games with higher prize levels.

That conclusion is based on scientific research, not intuition. Anyone who suggests that a budget problem can be solved simply by taking lottery money from pile A (prizes) and switching it to pile B (local aid) is indulging in dangerous speculation. Before approving any ceiling on prize money, we would strongly urge a small sample of opinion from players. Ask them if they want prize money from the lottery reduced.

In 1983 with prize levels of 50%, net revenues from the Instant Games totalled $18.5 million. By 1988, with prizes pegged at 65%, net revenues amounted to $116.7 million, an increase of $100 million for the cities and towns. (*See accompanying chart*).

Reducing the prize money would be the beginning of the end of the success story of the Massachusetts State Lottery. We have been the number one lottery in the country for many years. Nationwide, we have the highest per capita sales and the highest return of net revenues per capita. The national average return per capita is $32.74. In Massachusetts, the per capita return is $74.90. That success dates from the period in which we increased prize levels in Instant Games and the lotto games.

In simplest terms, the Lottery could produce 40% of $364 million --$145 million as in 1983 or 30 % of $1.5 billion-- or $450 million as in 1988. The key result is an increase in real dollars, not vague percentages. (*See accompanying chart*).

With an effort to get more from the administrative dollar, the Massachusetts Lottery runs one of the most efficient operations in the country. All administrative expenses cost 4.4 % of gross, a figure which private industry would be hard-pressed to match. The national average in FY 88, according to the nationally known "Big 8" accounting firm, Laventhal & Horwath, is 6.2 % of gross.

The lottery's budget has been stable through the past five years, rising from $49 million in FY 1986 to $64 million in FY 1990. Gross revenue during the same period rose from $1.1 billion to $1.5 billion.

Other states look to Massachusetts as the industry leader. In Missouri recently, sales increased by 32 % when a restriction on prize money was lifted by referendum. The Lottery Director Michael H. Morris said, "Probably the biggest reason for the sales increase is that now, under the new law, we can pay out more money in prizes....It proves that if you give your customers what they want, they will buy your product."

The 1989 survey of the U.S. gaming industry by Laventhal & Horwath, which has produced such a report each year for the past ten years, notes in its introduction "...in Fiscal 1988 several older state lotteries produced significant gains. The reason for these successes like all examples of growth in any consumer-driven business, was that they gave their customers a product that attracted and pleased."

With lotto sales flattening, Connecticut this year boosted prize levels in their game which has been one of the most successful in the country. Michigan, Illinois, New York and Ohio are among the major lottery states which are increasing prize levels based on their observations of what the Massachusetts experience has been.

The Massachusetts State Lottery is the model on which many other state lotteries and in fact some foreign lotteries have established themselves. We have led the way in Instant Game tickets, Lotto games, numbers games and are on the verge of installing new technologies in the Instant Games which other states are clamoring for.

The state of Ohio has installed a number of features in its games including higher prize structures borrowed directly from the Massachusetts system. Ohio Lottery Director Ronald Nabakowski said at a recent lottery conference, "When you look for leadership in the lottery industry, you need look no further than Massachusetts."

We run the Massachusetts State Lottery like a business. There may be differences of opinion about the mechanisms of operation, but there has been no denying that the hard work and innovation of all the employees at the lottery over the years has brought tangible results for the Commonwealth. Each year more and more has been earned for the cities and towns.

There should be a reason to change strategies in the midst of a continuing upswing in business and a constant increase in net earnings. There have been no convincing arguments advanced to date.

AGENT EXPENSES AND ADVERTISING COSTS 1983--1988

	ADVERTISING	% OF GROSS
1983	$ 6,914,453	.019
1984	$ 9,024,369	.013
1985	$10,753,761	.011
1986	$11,786,628	.010
1987	$10,210,094	.008
1988	$11,414,687	.008

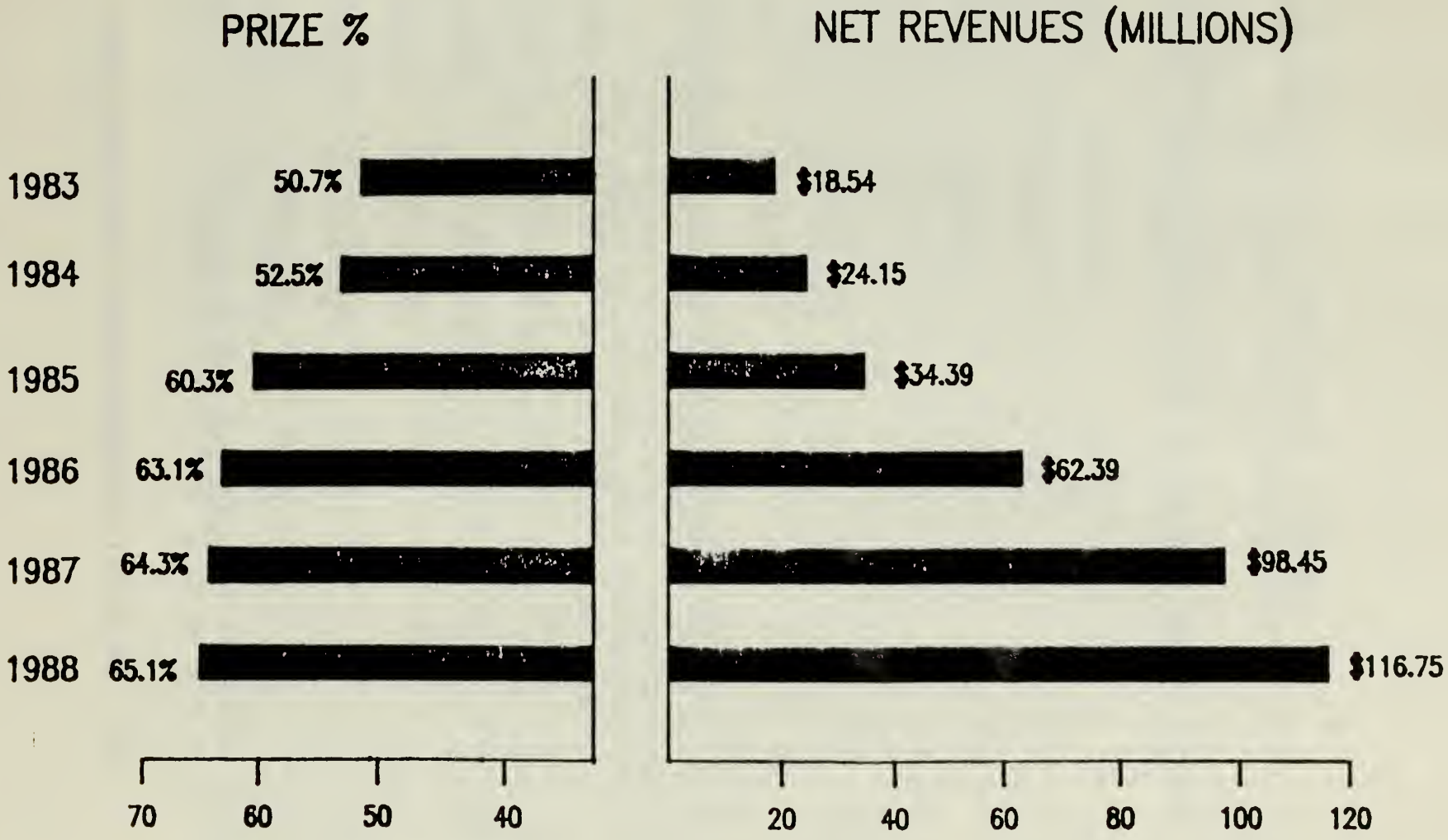
COMMISSIONS AND BONUSES TO STORES 1983--1988

1983	$19,479,852	.055
1984	$38,324,009	.055
1985	$54,707,364	.056
1986	$64,009,427	.056
1987	$72,607,723	.057
1988	$79,223,389	.057

The national average of operating expense is .062. Massachusetts operates at .039.

The national average return per capita is $32.74. In Massachusetts the per capita return is $74.90.

EFFECT OF INCREASING PRIZE % ON TOTAL REVENUES
EXAMPLE – INSTANT GAMES



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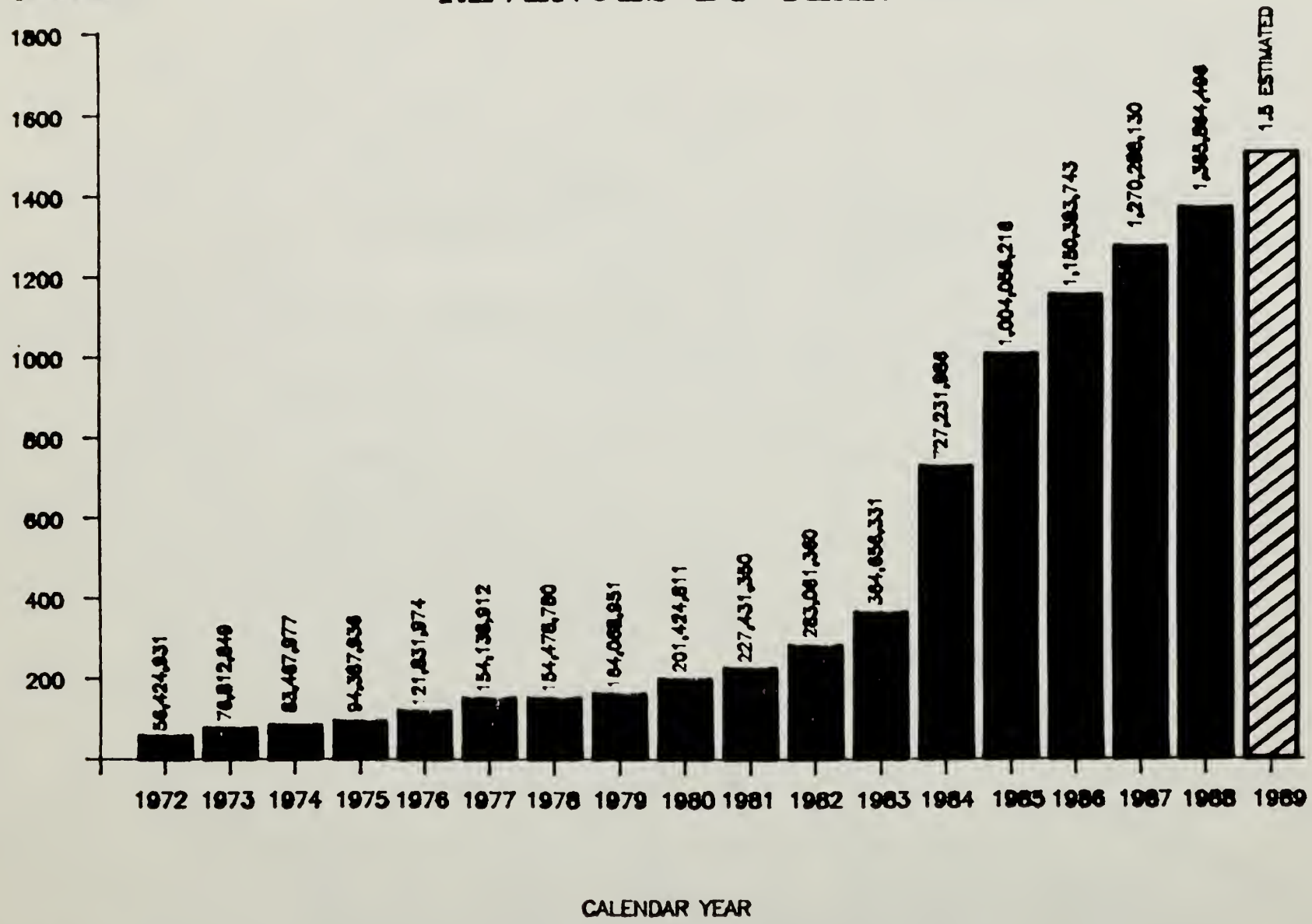
MASSACHUSETTS STATE LOTTERY

REVENUES BY YEAR



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ALLOCATION OF REVENUES – FY 1989